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B.Com Honours | Semester VI | Calicut University

FUNDRAISING SERVICES IN INVESTMENT BANKING

Course Code: COM6EJ315 • Module 2 Notes

Module II: Introduction to Underwriting

Covers underwriting concept, sub-underwriting, underwriting commission limits, underwriting agreement, devolvement notice, fixed price vs book-built underwriting, US models, & Green Shoe Options.

Unit 7: Underwriting Concept, Commission, & Devolvement Notice

Underwriting Obligation: Financial guarantee by investment bank to subscribe to unsubscribed portion of public issue. Underwriting Commission limits (Companies Act Sec 40(6)): Shares max 5%, Debentures max 2.5%. Devolvement notice issued when public subscription falls below 90%.

Unit 8: Business Models – Fixed Price vs Book-Built Underwriting

Underwriting Business Models: Syndicate members underwrite specific allocation tranches. In Book-built offers, underwriting obligation triggers post price discovery.

Unit 9: Assessment for Underwriting & US Models (Firm vs Best Efforts)

Underwriting Models:
- **Firm Commitment Underwriting (US Model):** Underwriter buys entire issue from issuer and resells to public, bearing 100% inventory risk.
- **Best Efforts Underwriting:** Underwriter acts purely as agent without guaranteeing unsold shares.

Unit 10: Underwriter Risks, Compensation, & Green Shoe Option

Green Shoe Option (Over-Allotment Option): Regulatory mechanism under SEBI allowing lead manager to over-allot shares up to 15% of issue size to stabilize post-listing market price volatility.

Practical Case Framework 1 (Firm Commitment vs Best Efforts Underwriting Comparison Matrix): Compare underwriting model, risk allocation, purchase commitment, and investment banker compensation structure.

Firm Commitment vs Best Efforts Underwriting Table:

Underwriting Model Type	Financial Risk Bearing Party	Underwriter Compensation & Revenue Basis
Firm Commitment Underwriting	Underwriter bears 100% unsold inventory risk	Underwriting spread (Selling Price - Purchase Price)
Best Efforts Underwriting	Issuer company bears unsold inventory risk	Flat agency placement fee per share sold
Standby Underwriting (Rights)	Underwriter subscribes strictly to unsubscribed shares	Standby fee + Devolvement commission %

Practical Case Framework 2 (Green Shoe Option Price Stabilization Mechanism Architecture): Detail Green Shoe stage, stabilizer action, share pool source, and market price impact.

Green Shoe Option (Over-Allotment) Execution Table:

Stabilization Execution Stage	Stabilizing Agent (Lead Manager) Action	Market Impact & Price Goal
1. Pre-Issue Allocation	Over-allot shares up to 15% borrowed from promoters	Creates short position & additional cash reserve pool
2. Post-Listing Price Decline	Buy shares from secondary market below IPO price	Supports share price; returns shares to promoters
3. Post-Listing Price Surge	Exercise Green Shoe Option to buy shares from issuer	Absorbs excess demand without promoter dilution